Supreme Court, U. S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-3

JAMAICA SAVINGS BANK,

Appellant,

against

LOUIS J. LEFKOWITZ, as Attorney General of the State of New York,

Appellee.

MOTION TO DISMISS OR AFFIRM

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TABLE OF CONTENTS

	PAGE
Preliminary Statement	1
Opinion Below	2
Jurisdiction	2
Statutory Provisions Involved	2
Question Presented	2
Statement of the Case	2
ARGUMENT—No constitutional or substantial federal question is presented on this appeal requiring full hearing before this Court	4
Conclusion	11

TABLE OF CASES

Arnett v. *Kennedy*, 416 U.S. 651 (1974)	4
Ball v. *Jamaica Savings Bank*, —— A.D.2d —— (2d Dept. 7/18/75)	5
Budd v. *New York*, 143 U.S. 517 (1892)	8
Burket v. *Bank of Hollywood*, 69 P.2d 421 (Calif. 1937)	6
California Auto Ass'n v. *Maloney*, 341 U.S. 105 (1951)	9
Carpenter v. *Suffolk Franklin Savings Bank*, 291 N.E. 2d 609 (Mass. 1973)	6
City of El Paso v. *Simmons*, 379 U.S. 497 (1965)	10
City of New York, Matter of [*Rockaway Beach*], 288 N.Y. 51 (1942)	6

PAGE

Dodge v. *Board of Education*, 302 U.S. 74 (1937) ... 8

Ferguson v. *Skrupa*, 372 U.S. 726 (1963) 9

German Alliance Co. v. *Lewis*, 233 U.S. 389 (1914) .. 8

Goss v. *Lopez*, —— U.S. ——, 43 U.S.L.W. 4181 (1/22/75) 4

Henningsen v. *Bloomfield Motors, Inc.*, 32 N.J. 358, 161 A.2d 69 (1960) 6

Home Building & Loan Ass'n. v. *Blaisdell*, 290 U.S. 398 (1934) 7, 8

Hudson Water Co. v. *McCarter*, 209 U.S. 349 (1908) 8

Idlewild Bon Voyage Liquor Corp. v. *Epstein*, 370 U.S. 713 (1962) 3

Ittleman, Matter of [*City of New York*], 286 N.Y. 150 (1941) 6

Jamaica Savings Bank v. *Lefkowitz*, 390 F.Supp. 1357 (E.D.N.Y. 1975) 6, 10

Long Island Water Supply Co. v. *Brooklyn*, 166 U.S. 685 (1897) 7

Manigault v. *Springs*, 199 U.S. 473 (1905) 7

Morehead v. *People ex rel. Tipaldo*, 298 U.S. 587 (1936) 6

Mourning v. *Family Publications Service, Inc.*, 411 U.S. 356 (1973) 5

Munn v. *Illinois*, 94 U.S. 113 (1876) 8

Nieves v. *Oswald*, 477 F.2d 1109 (2d Cir. 1973) 3

New York State Thruway Authority v. *Hurd*, 25 N.Y.2d 150 (1969) 6

PAGE

New York Trust Co. v. *Eisner*, 256 U.S. 345 (1921) .. 7

Rast v. *Van Deman & Lewis*, 216 U.S. 42 (1916) 8, 9

Rodgers v. *Clement*, 162 N.Y. 422 (1900) 6

Rosario v. *Rockefeller*, 410 U.S. 352 (1973) 6

Siegelman v. *Cunard White Star*, 221 F.2d 189 (2d Cir. 1955) 6

Sproles v. *Binford*, 286 U.S. 374 (1932) 8

Staten Island Loaders v. *Waterfront Comm'n of New York Harbor*, 117 F.Supp. 308 (S.D.N.Y. 1953), affd. 347 U.S. 439 (1954) 9

Stephenson v. *Binford*, 287 U.S. 251 (1934) 8

Stone v. *Farmers Loan & Trust Co.*, 116 U.S. 307 (1886) 8, 9

Surrey Strathmore v. *Dollar Savings Bank*, 36 NY 2d 173 (1975) 5, 6

Union Dry Goods Co. v. *Georgia Public Service Corp.*, 248 U.S. 372 (1919) 8

United States v. *Bethlehem Steel Corp.*, 315 U.S. 289 (1942) 6

Viex v. *Sixth Ward Building & Loan Ass'n*, 310 U.S. 32 (1940) 8

Walz v. *Tax Comm'n.*, 397 U.S. 664 (1970) 7

Weinberger v. *Salfi*, —— U.S. ——, 43 U.S.L.W. 4985 4

CONSTITUTION, STATUTES AND REGULATIONS

United States Constitution

Art. I, Sec. 10 1

Fourteenth Amendment 1

	PAGE
Federal Statutes	
28 U.S.C. § 1253	2
§ 2281	3
§ 2284	3
42 U.S.C. § 1983	1
Rule of the Supreme Court	
Rule 16	1
State Statutes	
Session Laws of New York	
Ch. 119, L. 1974	2, 3
Ch. 528, L. 1943	9
Banking Law	
Article VI	2
§ 10	4
§ 14-b	2, 3
§ 235, subd. 6(a)	4, 9
§ 235, subd. 6(b)	5, 9
§ 244, subd. 4	5
§ 245	5
General Obligations Law § 5-601	2
Miscellaneous	
Kessler, "Contracts of Adhesion—Some Thoughts About Freedom of Contract," 43 Colum. L. Rev. 629 (1943)	6

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Appellant,

against

Louis J. Lefkowitz, as Attorney General of the State of New York,

Appellee.

MOTION TO DISMISS OR AFFIRM

Appellee, the Attorney General of the State of New York, pursuant to Rule 16 of the Rules of this Court, moves that the final judgment of the United States District Court for the Eastern District of New York be affirmed or, in the alternative, that this appeal be dismissed.

Preliminary Statement

This is an appeal from a judgment of a three-judge panel of the United States District Court for the Eastern District of New York, dismissing appellant's claim under 42 U.S.C. § 1983, Article I, Section 10 of, and the Fourteenth Amendment to the United States Constitution. The judgment was entered March 6, 1975.

Opinion Below

The opinion of the United States District Court for the Eastern District of New York dated March 3, 1975, is reported at 390 F. Supp. 1357 and is also attached to Appellant's Jurisdictional Statement as Appendix A.

Jurisdiction

Appellant seeks to invoke the jurisdiction of this Court under 28 U.S.C. § 1253.

Statutory Provisions Involved

Chapter 119 of the New York Laws of 1974, which adds, *inter alia,* § 14-b of New York Banking Law and New York General Obligations Law, § 5-601, are set out in Appendix D to Appellant's Jurisdictional Statement.

Question Presented

Does the constitutionality of Chapter 119 of the Laws of 1974, which provides for the payment of interest on mortgage escrow accounts on certain mortgages, raise a substantial federal question requiring a plenary review by this Court?

Statement of the Case

On July 16, 1974, appellant, a mutual savings bank, organized under and doing business in the State of New York by virtue of Article VI of the New York Banking Law, commenced an action in the United States District Court for the Eastern District of New York seeking declaratory and injunctive relief declaring certain provisions of the Banking Law and the General Obligations Law unconstitu-

tional and enjoining their enforcement. The challenged provisions amend N.Y. Banking ..... which require..... by mandating the payment of at least 2% interest on escrow accounts for the payment of taxes and insurance established pursuant to certain bond and mortgages on one to six-family *owner-occupied* homes in New York State. The statute, L. 1974, ch. 119 applied to all such mortgages, regardless of the date of execution with certain exceptions. Banking Law § 14-b, subd. 4,* but only as to escrow payments made after its effective date. Appellant asserted three bases for its claim—violation of the "contracts" clause, deprivation of due process and equal protection.**

It thereafter moved, pursuant to 28 U.S.C. §§ 2281, 2284, to convene a statutory three-judge court and appellee cross-moved to dismiss for lack of a substantial federal question, and therefore absence of jurisdiction, and for failure to state a claim for which relief can be granted. On August 29, 1974, the District Court (Constantino, D.J.) granted plaintiff's motion, on the grounds that the prerequisites for a three-judge court were present. See *Idlewild Bon Voyage Liquor* v. *Epstein,* 370 U.S. 713 (1962); *Nieves* v. *Oswald,* 477 F. 2d 1109 (2d Cir., 1973).

Thereafter, the court was convened, and the case heard on stipulated facts, and on March 3, 1975, the court (Gurfein, C.J., Constantino and Knapp, D.JJ.) rendered its decision upholding the statute on the alternative grounds that there was no "contract" impaired and even if there was one, it was subject to the exercise of the State's police power of which the challenged statute was a valid exer-

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* These exceptions include instances where a mortgage agreement executed before the act's date of purchase contains an express disclaimer of the obligation to pay interest or where the mortgagee is prohibited from earning a return on the monies held in escrow.

** Apparently all but the contracts claim have been abandoned on this appeal.

cise. The district court also rejected plaintiff's equal protection claim, holding that the distinction complained of had a rational basis. See, e.g. *Weinberger* v. *Salfi*, —— U.S. ——, 43 U.S.L.W. 4985 (6/25/75). In addition the court rejected plaintiff's due process argument on the grounds that no property interest was interfered with. See *Arnett* v. *Kennedy*, 416 U.S. 651 (1974); *Goss* v. *Lopez*, —— U.S. ——, 43 U.S.L.W. 4181 (1/22/75).

On March 6, 1975, a judgment was entered granting defendant's cross-motion to dismiss the complaint. It is this judgment from which plaintiff has appealed.

ARGUMENT

No constitutional or substantial federal question is presented on this appeal requiring full hearing before this Court.

(1)

The case at bar presents no real semblance of a constitutional question. It is clear beyond cavil that mutual savings banks, which owe their very existence to the authority of the State, are subject to the complete and close supervision of the licensing authority to *inter alia* protect the interest. (N.Y. Banking Law § 10). Banking Law § 235 contains within its confines the permissible investments for entities such as appellant, and it is from this statute that mutual savings banks draw the power to create mortgage escrow accounts. Thus the question in this case reduces itself to whether the Constitution prohibits a state, once having created a power, from preventing its abuse. This question must be answered in the negative.

An escrow account is one established to more fully secure a mortgage loan. It accomplishes this goal by permitting the mortgagee bank to collect from the mortgagor taxes and insurance premiums due on the mort-

gaged premises. It would be a strange exercise of the State's power, to say the least, if the purpose of such a statute was to allow mortgagees to take these funds, in no sense of the word, theirs, invest and earn a return thereon, and, without any express agreement thereon, keep the funds for itself.* While the statutory provision (Banking Law § 235, subd. 6[b]) contained no affirmative requirement that banks pay interest on mortgage escrow accounts nor any provision permitting the bank to invest these funds, when it subsequently appeared that the banks, including appellant, were, without so much as a clause in the agreement to that effect, earning as much as ten million dollars state-wide on these escrow accounts, and distributing not one penny to the homeowners whose funds these were, and the state courts differed on the right on the mortgagor-depositor to obtain the benefit of these funds,** the Legislature acted to protect the small homeowner from the inequitable practice.

It can hardly be said that contracts in which one party because of its superior bargaining power imposes its terms upon another *sub silento* without restraint or let, are in fact "contracts". See *Surrey Strathmore* v. *Dollar Savings Bank, supra*, 36 N Y 2d at 178. Such "contracts", if they may be so dignified, are in no way protected by the Constitution, and, as the District Court found are the proper subject of remedial Legislation.*** *Jamaica Sav-*

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* It is stranger yet in the case of a depositor-owned mutual savings bank to extort funds from one class of owners for payment to another. See Banking Law §§ 244, subd. 4 and 245.

** See *Surrey Strathmore* v. *Dollar Savings Bank*, 36 NY 2d 173 (1975); *Ball* v. *Jamaica Savings Bank*, —— A D 2d —— (2d Dept. 7/18/75) (MUNDER, J. concurring).

*** To detail the statutes seeking to remedy this imbalance, is not here appropriate, other than to note that they pervade the law. See discussion *Mourning* v. *Family Publications Service, Inc.*,

(footnote continued on following page)

ings Bank v. *Lefkowitz,* 390 F. Supp. at 1362 (E.D.N.Y., 1975). The fact that an obligation to pay interest will not be implied in law, in no way means that such obligation will not be, in an appropriate commercial context, implied in fact. *New York State Thruway Authority* v. *Hurd,* 25 N Y 2d 150, 157-158 (1969); *Rodgers* v. *Clement,* 162 N.Y. 422, 425-426 (1900). Such was the implicit finding of the District Court herein, and of the Court of Appeals *Surrey Strathmore, supra.*•

It is thus clear that the statute, speaking as it does to a subject upon which the agreement is silent, and upon which the law, at best, is unclear, does not impair the obligations of contract, for there is, in fact no agreement to be impaired. See, e.g. *Carpenter* v. *Suffolk Franklin Savings Bank,* 291 N.E. 2d 609 (Mass. 1973); *Burket* v. *Bank of Hollywood,* 69 P. 2d 421 (Calf. 1937).

(footnote continued from preceding page)

411 U.S. 356, 377 (1973); see also *Rosario* v. *Rockefeller,* 410 U.S. 352 (1973). Indeed, if there is any theme that pervades our legislation, it is precisely that here present—to eliminate abuses resulting from unbalanced bargaining power. *Morehead* v. *People ex rel. Tipaldo,* 298 U.S. 587, 627 (HUGHES, Ch.J. dissenting); *United States* v. *Bethlehem Steel Corp.,* 315 U.S. 289, 326 (1942) (FRANKFURTER, J., dissenting). Perhaps the most cogent statement is that found in *Henningsen* v. *Bloomfield Motor Inc.,* 32 N.J. 358, 161 A. 2d 69, 86 (1960), to the effect that contracts of adhesion are not contracts at all and therefore not entitled to the same respect accorded contracts arrived at by arms length bargaining.

See Kessler, "Contracts of Adhesion—Some Thoughts About Freedom of Contract," 43 Colum. L. Rev. 629, 632 (1943). See also *Siegelman* v. *Cunard White Star,* 221 F. 2d 189, 206 (2d Cir. 1955).

• It is interesting to note that while an obligation to pay interest may not, in the absence of a statute, be implied in law, as the Legislature specifically reserved the right to require the payment of interest, that reservation must have been contemplated by the parties to the mortgage agreement and thereby have become part of the agreement with the same effect as if set out at length. *Matter of City of New York* [*Rockaway Beach*], 288 N.Y. 51 (1942); *Matter of Ittleman* [*City of New York*], 286 N.Y. 150 (1941).

(2)

Assuming *arguendo* that New York law was sufficiently specific that the disclaimer to pay interest was implied from silence, the statute, nevertheless is not constitutionally deficient. Appellant, as it must, concedes that all contracts are subservient to the reserved attributes of sovereignty retained by the State. It has nevertheless erroneously urged upon this Court such a narrow reading of the reserve or "police" power, as if to make it virtually meaningless.

The starting point of analysis is, of course, this Court's authoritative discussion of the meaning of the contracts clause in *Home Building & Loan Ass'n* v. *Blaisdell,* 290 U.S. 398 (1934). There, this Court, echoing language written forty years earlier in *Long Island Water Supply Co.* v. *Brooklyn,* 166 U.S. 685, 692-3 (1897), wrote that all contracts carry with them the implication that such contracts is entered into subject to and modifiable by the exercise of the sovereign's police power.

In *Manigault* v. *Springs,* 199 U.S. 473, 480 (1905), the court defined the parameters of this reserved power to include the preservation of the lives, health, moral comfort and general welfare of the people.

This has been the settled law of the contracts clause and of this Court for well over three-quarters of a century, and that in the necessarily ephemeral area of constitutional law, it has been such for as long is ample evidence of its wisdom.•

Under this principle, legislation regulating industries and impairing their contracts have been sustained in areas having even a more tenuous connection with protecting

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• As Mr. Justice Holmes observed in *New York Trust Co.* v. *Eisner,* 256 U.S. 345, 349 (1921): "A page of history is worth [in resolving such questions of interpretation,] a volume of logic." See also *Walz* v. *Tax Comm'n,* 397 U.S. 664, 678, 681 (1970).

the public good than in the regulation of mortgage and banking transactions.

The Court has upheld legislation regulating common and "contract" carriers' use of the public roads even though there are interferences with preexisting contracts. *Sproles* v. *Binford,* 286 U.S. 374 (1932); *Stephenson* v. *Binford,* 287 U.S. 251 (1934); *Union Dry Goods Co.* v. *Georgia Public Service Corp.,* 248 U.S. 372 (1919) (regulation of utility rates); *Munn* v. *Illinois,* 94 U.S. 113 (1876); *Budd* v. *New York,* 143 U.S. 517 (1892) (regulation of charges for grain storage); *German Alliance Ins. Co.* v. *Lewis,* 233 U.S. 389 (1914) (regulation of insurance rates).

See also *Stone* v. *Farmer's Loan & Trust Co.,* 116 U.S. 307 (1886), where the Court concluded that a statute, regulating prices charged by common carriers "comes clearly within the supervising power of the State in the affairs of its domestic corporations." 116 U.S. at 333.

Finally in *Rast* v. *Van Deman & Lewis,* 216 U.S. 342, 316 (1916), the Court put to rest appellant's case in words that cannot be misconstrued:

> "Besides, as the business is subject to regulation the contracts made in its conduct are subject to such regulations."

See *Home Building & Loan Assn.* v. *Blaisdell, supra,* 290 U.S. at 442; *Dodge* v. *Board of Education,* 302 U.S. 74 (1937); *Viex* v. *Sixth Ward Building & Loan Ass'n,* 310 U.S. 32 (1940); *Hudson Water Co.* v. *McCarter,* 209 U.S. 349, 357 (1908).

Indeed, by the prescription of the payment of two per-cent to the mortgagor, the legislature has, for the first time, explicitly countenanced the use by the bank of such escrow deposits and the retention by the bank of most of the interest earned (5½ per cent is paid by the bank to

depositors on deposits which may be withdrawn at any time). Indeed the Legislature could well have directed that the escrowee for the payment of taxes be a public agency or have terminated the entire provision. *Staten Island Loaders* v. *Waterfront Comm'n of New York Harbor,* 117 F. Supp. 308 (S.D.N.Y. 1953), *aff'd.* 347 U.S. 439 (1954); *Ferguson* v. *Skrupa,* 372 U.S. 726 (1963); *California Auto Ass'n* v. *Maloney,* 341 U.S. 105, 110 (1951). That it did less, does not create a constitutional problem worthy of this Court's consideration.

In sum therefore, the District Court's decision is patently correct. Appellant's power, duties and obligations stem from their corporate charter and the Banking Law. Among the powers granted plaintiff is the right to lend money to the public on the strength of collateral in the form of mortgages. McKinney's Banking Law § 235, subd. 6(a), (b). They are also empowered (and in low equity mortgages required) to each month collect one-twelfth of the yearly real estate and school taxes, water rents and insurance premiums and at the appropriate time turn the funds so held to those to whom they are due. McKinney's Banking Law § 235, subd. 6(b).* Thus, under *Rast, supra,* since State chartered banks even more than domestic business corporations are subject to regulation as quasi-public utilities, so their contracts must be. *Stone* v. *Farmers Loan & Trust Company,* 116 U.S. 307, 333 (1886).

It can scarcely be disputed that even assuming *arguendo,* that the ability to earn interest was a central, albeit unstated term of the contract, the control of interest rates is a proper exercise of the State's police power and the challenged statute is an appropriate exercise of that power. It is clear, despite plaintiff's protestations to the contrary, that corrections of imbalances in bargaining

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* Enacted Session Laws of New York, 1943, Chapter 528.

relationships have long been and are still a proper subject of state and federal concern.* See *Jamaica Savings Bank* v. *Lefkowitz, supra,* 390 F. Supp. at 1362. This was recognized in *City of El Paso* v. *Simmons,* 379 U.S. 497, 575 (1965), where the court wrote:

> "This Court's decisions have never given a law which imposes unforeseen advantages or burdens on a contracting party constitutional immunity against change."

It is recognized here.

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* Appellant has asserted in that it would not have entered into the mortgage agreement if it had to pay interest on the escrow account and therefore it was central to the bargain. It thereby posits a subjective rather than an objective test of what is central. This Court has rejected such a subjective approach. *City of El Paso, supra.*

Actually this is not seriously asserted because the appellant has been entering into new mortgage agreements since the enactment of the interest requirement.

CONCLUSION

For the reasons herein stated, the appeal should be dismissed or the decision and order should be affirmed.

Dated: New York, New York, August 15, 1975.

Respectfully submitted,

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